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UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

CLAYTON D. BLEHM, dba FDC Investments, Inc.,

Plaintiff,

v.

BETSY MCINTYRE and QUIKSILVER, INC.,

Defendants.

Case No. 08CV1358 BTM NLS

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF QUIKSILVER INC.'S MOTION TO DISMISS PLAINTIFF'S COMPLAINT OR, IN THE ALTERNATIVE, MOTION TO STAY ACTION PENDING RESOLUTION OF PRIOR STATE COURT ACTION

Date: October 17, 2008
Time: 11:00 a.m.

Judge: Hon. Barry Ted Moskowitz
Courtroom: 15

Per Chambers, No Oral Argument Unless Requested by the Court

[Notice of Motion and Motion to Dismiss; Request for Judicial Notice; and Declaration of Molly J. Magnuson filed concurrently herewith]

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Defendant Quiksilver, Inc. ("Quiksilver") hereby submits the following Memorandum of Points and Authorities in support of its concurrently filed Notice of Motion and Motion to Dismiss Plaintiff's Complaint or, in the Alternative, Motion to Stay Action Pending Resolution of Prior State Court Action:

MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION.

This is not the first time that Plaintiff Clayton D. Blehm, dba FDC Investments, Inc. ("Plaintiff," "Blehm" and/or "FDC") has brought a lawsuit to redress the alleged wrongs contained in his recently filed complaint (the "Complaint"). Indeed, just months ago, in a California state court, the allegations at issue in the Complaint were tried by Plaintiff before a Court and jury, resulting in a defense verdict on all claims.

In an attempted end-run around the Judgment entered in the prior state court action, Plaintiff has filed this action, attempting in his Complaint to conjure up some new basis for filing suit. Most notably, while in the prior action Plaintiff sued DC Shoes, Inc. ("DC Shoes"), the company of which he was formerly Chief Financial Officer, a thirty percent shareholder and director, here he sues Quiksilver – apparently based upon Quiksilver's subsequent acquisition of DC Shoes well after the relevant time period alleged in the Complaint; indeed, Plaintiff alleges no independent basis for his purported claims against Quiksilver. Judgment in the prior state court action was entered and served on Plaintiff's counsel on January 4, 2008. The Judgment therefore became final when Plaintiff failed to timely appeal. Accordingly, Plaintiff's claims should be dismissed on the grounds that they are barred from relitigation by res judicata.

Even if Plaintiff had timely appealed in the prior state court action and the Judgment therefore was not yet final, this Court should properly exercise its discretion to stay this action pending resolution of the prior state court proceeding under the abstention principles articulated by the United States Supreme Court in

Colorado River Water Conservation Dist. v. United States, 424 U.S. 800 (1976). Accordingly, Quiksilver hereby moves the Court, in the alternative, for a stay of this action pending resolution of the prior state court action.

Finally, the Complaint also fails because Plaintiff's claims lack the particularity required under Rule 9(b). Under Rule 9(b), Plaintiff must allege, among other things, the specific information Quiksilver failed to disclose, why it had a duty to make such disclosure, who specifically had an obligation to make such disclosure on Quiksilver's behalf, when such a disclosure should have been made and how Plaintiff detrimentally relied on such non-disclosure. Plaintiff's rambling allegations fall far short of Rule 9(b)'s requirements. Indeed, what should be very apparent from the Complaint's allegations is that Plaintiff cannot ***in good faith*** allege any wrongdoing on the part of Quiksilver.

On these grounds, and as set forth more fully below, Quiksilver hereby requests that the Court grant its Motion to Dismiss Plaintiff's Complaint or, in the alternative, grant its Motion to Stay the action pending resolution of the prior action pending in state court.

II. FACTUAL BACKGROUND AND SUMMARY OF PLAINTIFF'S ALLEGATIONS.[1]

A. Blehm's Employment at and Termination from DC Shoes.

Plaintiff Blehm was the former Chief Financial Officer and a former director of DC Shoes, a San Diego-based company. (Complaint ¶ 6.) Additionally, Blehm, through his corporation, FDC, was a 30% shareholder of DC Shoes stock.

[1] In addressing this Motion, the Court is to assume all the facts as pled by Plaintiff to be true. Quiksilver, however, denies Plaintiff's allegations, and nothing herein should be construed as a concession to any fact pled, or a waiver of Quiksilver's right to deny and challenge any of Plaintiff's allegations at the appropriate time. Further, in ruling on this Motion, the Court may consider documents of which it is permitted to take judicial notice. *See, e.g., Intri-Plex Technologies, Inc. v. Crest Group, Inc.*, 499 F.3d 1048, 1052 (9th Cir. 2007) (on a 12(b)(6) motion, the Court may "take judicial notice of matters of public record without converting a motion to dismiss into a motion for summary judgment," as long as the facts noticed are not "subject to reasonable dispute.").

(*Id.*)

Prior to 2002, Blehm's employment agreement was structured in such a way that Blehm was paid by DC Shoes through his personal corporation, FDC. (*See id.* ¶ 17.) In connection with an audit of DC Shoes conducted by the Internal Revenue Service (the "IRS") which began in 2001, the IRS determined that Blehm was an employee of DC Shoes, rather than an independent contractor, and that, therefore, DC Shoes should have withheld amounts from his paycheck and should have paid employment taxes thereon. (*See id.* ¶¶ 15-18.) It was the IRS's position that DC Shoes owed $1.8 million, exclusive of interest and penalties, for unpaid payroll or employment taxes relating to Blehm's employment at DC Shoes. (*See id.* ¶ 18.)

Blehm's employment from DC Shoes was subsequently terminated in June 2002. (*See id.* ¶ 21.)

B. Blehm Files a Lawsuit Against DC Shoes, DC Shoes Cross-Complains and the Parties Ultimately Settle Their Claims.

Just months after his termination from DC Shoes, in October 2002 Blehm initiated a lawsuit in the San Diego Superior Court against DC Shoes and others, alleging wrongful termination and other claims related to his employment at DC Shoes. (*See id.* ¶ 26; Request for Judicial Notice filed concurrently herewith ("RJN") Ex. 1[2] (Wrongful Termination Complaint).) DC Shoes proceeded to file a Cross-Complaint against Blehm and FDC. (RJN Ex. 2 (DC Shoes' Cross-Complaint).) In its Second Amended Cross-Complaint, DC Shoes alleged that,

[2] In considering this Motion to Dismiss, the Court may take judicial notice of the documents filed in other courts in actions related hereto. *See* Fed. R. Evid. § 201 (the Court "shall take judicial notice [of adjudicative facts] if requested by a party and supplied with the necessary information). "Materials from a proceeding in another tribunal are appropriate for judicial notice." *Papai v. Harbor Tug & Barge Co.*, 67 F.3d 203, 207 n.5 (9th Cir.1995), rev'd on other grounds, 520 U.S. 548 (1997) (taking judicial notice of a decision and order of an Administrative Law Judge); *see also Meredith v. Oregon*, 321 F.3d 807, 817 n.10 (9th Cir. 2003) (taking judicial notice of filings in Oregon Court of Appeals); *Intri-Plex Technologies, Inc.*, 499 F.3d at 1052 (taking judicial notice of filings in related action on motion to dismiss).

while at DC Shoes, Blehm had, among other things, breached his fiduciary duties to the Company, had breached his employment agreement, had committed fraud and had converted corporate assets for his own use. (*See id.*)

Ultimately, the parties settled their claims, entering into a settlement agreement and release on August 20, 2003 (the "Settlement Agreement"). (*See id.* ¶ 27.) The Settlement Agreement provided that Blehm would receive $15 million in consideration from DC Shoes payable over a specified period of time, both sides would dismiss their lawsuits and release each other of liability and FDC would sell back its DC Shoes stock to the Company. (*See* RJN Ex. 3 (Settlement Agreement), at 1-3.)[3] The Settlement Agreement also provided that "DC Shall acknowledge and agree that (i) the claim made by the Internal Revenue Service for unpaid taxes relating to Blehm's prior employment with DC Shoes, in the approximate amount of $1,800,000, plus all applicable interest and penalties . . . is the sole responsibility of DC Shoes, and (ii) none of the FDC Parties shall have any liability or obligation to DC Shoes in connection with the IRS Claim." (*Id.* at 2.)

As alleged in the Complaint, DC Shoes had contemplated a sale of the Company for quite some time. In early 2002, for example, while Blehm was still CFO of DC Shoes, DC Shoes engaged in negotiations with Billabong, a well-known Australian company in the action sports market, regarding a possible sale of the Company. (*See* Complaint ¶¶ 8-13.) This sale, however, never came to fruition. (*See id.*) Ultimately, in early 2004, DC Shoes entered into an agreement for the sale of DC Shoes to Quiksilver. (*See id.* ¶ 29.) The sale to Quiksilver closed a few months later. (*See id.*)

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[3] For the reasons set forth in note 3, the Court may also consider the Settlement Agreement because it was attached to the complaint filed by Blehm in his action against DC Shoes, filed in the San Diego Superior Court on or about August 17, 2006. Further, the Court may also take judicial notice of the Settlement Agreement, the contents of which are alleged in the Complaint. *See Branch v. Tunnell*, 14 F.3d 449 (9th Cir. 1994) ("documents whose contents are alleged in a complaint and whose authenticity no party questions, but which are not physically attached to the pleading, may be considered in ruling on a Rule 12(b)(6) motion to dismiss.").

C. DC Shoes Settles the IRS's Claim Against DC Shoes for Unpaid Employment Taxes Relating to Blehm's Prior Employment at DC Shoes.

As noted above and in the Complaint, in April 2002 the IRS took the position that DC Shoes owed $1.8 million, plus interest and penalties, for its failure to withhold amounts from Blehm's paycheck. (*See id.* ¶ 18.)

In September 2003, DC Shoes ultimately reached an agreement with the IRS regarding the amounts DC Shoes would have to pay to settle the IRS's claim for unpaid taxes relating to Blehm's prior employment at DC Shoes. (*See* RJN Ex. 4 (Tax Court Decision).) As noted in the Complaint, the stipulated agreement with the IRS was under Internal Revenue Code Section 3509 ("Section 3509"). (*See* Complaint ¶ 30.) Section 3509 is the Code Section that applies to a determination of an employer's liability for certain employment taxes. (*See* RJN Ex. 5.) It allows the employer to resolve its employment tax liability by paying a penalty equal to a percentage of the total amount that should have been withheld. (*See id.* § 3509(a), (b).) By the express terms of the statute, the resolution of an employer's liability under Section 3509 does not affect the income tax liability of the employee. (*See id.* § 3509(d)(1)(A).) Thus, the IRS's agreement with DC Shoes under Section 3509 resulted in DC Shoes paying a penalty equal to a percentage of the total withholding amounts originally claimed by the IRS. (*See* RJN Ex. 4 (Tax Court Decision).) And, as expressly provided in the Statute, Blehm's personal income tax liability was not affected by this resolution – he did not get a credit or deduction against any income tax he personally owed to the IRS.

D. Blehm Files Suit Against DC Shoes and Its Principals.

On July 14, 2005, over a year after they received the balance of the $15 million owed to them under the Settlement Agreement, Blehm and FDC filed suit against DC Shoes and its principals in this Court. (RJN Ex. 6 (District Court Complaint).) After this action was dismissed by the District Court (*id.* Ex. 7 (Dismissal), Blehm and FDC filed a nearly identical suit in the San Diego Superior

Court (the "State Court Action"). (*See id.* Ex. 8 (State Court Complaint).)

In the State Court Action, Blehm and FDC alleged a number of claims against DC Shoes and its principals, including breach of contract, fraud, breach of fiduciary duty and related causes of action. (*See id.*) Plaintiffs' breach of contract claim was based on DC Shoes' alleged failure to pay Blehm's personal income taxes, as Plaintiffs contended it was required to do under Section 5 of the Settlement Agreement. (*See id.* ¶¶ 64-68.) Plaintiffs also asserted two distinct fraud theories based on misrepresentations and/or omissions allegedly made by DC Shoes at the time the parties entered into the Settlement Agreement in August 2003. First, Plaintiffs claimed that DC Shoes failed to disclose that, at the time the parties entered into the Settlement Agreement, it was negotiating with third parties for the sale of DC Shoes. (*See, e.g., id.* ¶¶ 36, 38-42.) Second, Plaintiffs claimed that DC Shoes falsely represented that it would pay Blehm's personal tax liability and failed to disclose that DC Shoes intended to settle its claims with the IRS under Section 3509, which had the result of precluding Blehm from getting a credit on his personal income taxes. Specifically, Plaintiffs alleged that:

- Defendants affirmatively represented that Defendants would "pay all taxes, penalties and interest owing to the Internal Revenue Service relating to Blehm's prior employment with DC [Shoes]." (*Id.* ¶ 37)
- "[Defendants] knew the representation to be false, in that . . . at the time these representations were made, [Defendants] knew that they would enter into a settlement with the [IRS] pursuant to Internal Revenue Code § 3509, so that Blehm would remain responsible for paying the taxes, penalties, and interest relating to Blehm's prior employment with DC." (*Id.*; *see also id.* ¶¶ 38-42; *see also id.* ¶¶ 69-76 (intentional misrepresentation cause of action based on same facts).)

E. The Trial of Blehm's State Court Action.

Blehm and FDC's claims proceeded to trial in October 2007 in the San Diego Superior Court before the Honorable David G. Brown. Prior to sending their claims to the jury, Blehm and FDC dropped their claim for fraud based on DC Shoes' failure to disclose its resolution of the IRS audit under Section 3509. Thus, only two claims ultimately went to the jury: (1) the breach of contract cause of action against DC Shoes based on an alleged breach of Section 5 of the Settlement Agreement; and (2) the fraud claim against DC Shoes based on DC Shoes' alleged failure to disclose to Plaintiffs that DC Shoes was talking to interested investors at the time the parties entered into the Settlement Agreement. (*See* RJN Ex. 9 (State Court Judgment).) The jury found in favor of DC Shoes on both claims. (*See id.* at 2-3) The Court subsequently ruled in DC Shoes' favor on Plaintiff's breach of fiduciary duty claim. (*See id.* at 4.) Judgment was entered by the Court on January 4, 2008 (*id.* at 5), and Blehm was served with a copy of the Judgment that same day. (*Id.* Ex. 10 (Court of Appeals Information Statement).)

On July 2, 2008, Blehm filed a motion for new trial and notice of appeal. (*Id.* Ex. 11 (Motion for New Trial); *id.* Ex. 12 (Notice of Appeal.) Both were untimely. Pursuant to applicable statutes, Plaintiffs were required to file their motion for new trial within fifteen days of service of the Judgment and to file their appeal within sixty days of service of the Judgment.

On August 1, 2008, DC Shoes moved to strike Plaintiffs' late-filed motion for new trial. (*Id.* Ex. 13 (Motion to Strike Motion for New Trial).) This matter is set to be heard by the court on August 26, 2008. DC Shoes also filed an opposition to Plaintiffs' motion for new trial on August 1, 2008, in part, on the grounds the motion was not timely. (*Id.* Ex. 14 (Opposition to Motion for New Trial).) DC Shoes expects that its motion to strike will be granted by the court.

On July 14, 2008, Plaintiffs filed an Information Statement with the California Court of Appeals. (*Id.* Ex. 10 (Court of Appeals Information

Statement).) In that document, Plaintiff notified the court that they had been served with a copy of the Judgment on January 4, 2008. (*See id.*) In the event the Court of Appeal does not dismiss the appeal on its own initiative based on the information provided to it by Plaintiff, DC Shoes intends to seek a dismissal of the appeal on the grounds that it was not timely.

F. Blehm's Allegations Against Quiksilver in this Lawsuit.

Although in his previous action against DC Shoes, Blehm alleged both that Quiksilver was in discussions with DC Shoes for the acquisition of the company at the time he and DC Shoes entered into the Settlement Agreement, and that Quiksilver ultimately acquired DC Shoes' stock in early 2004, Quiksilver was not named as a party in that suit. (*See generally,* RJN Ex. 8.) Indeed, it was not until he ultimately failed to recover from DC Shoes at trial, that Blehm filed this action against DC Shoes' parent company, Quiksilver.

Many of the same issues already litigated by Blehm in his previous action against DC Shoes are now raised here, specifically, the issues surrounding Blehm's claim of fraud based on a failure to disclose the Section 3509 agreement between DC Shoes and the IRS. The Complaint alleges that Quiksilver (along with IRS agent McIntyre) fraudulently failed to disclose that, prior to entering into the Settlement Agreement "DC Shoes and the IRS had agreed under Section 3509 of the IRS code that DC Shoes would be relieved of any requirement to pay the employment taxes . . . ." (Complaint ¶ 27; *see also id.* ¶ 45 ("[O]n or about July 2003 . . . [Quiksilver] failed to disclose to [Blehm] that they had reached a settlement in the IRS/DC Shoes matter."); *id.* ¶ 50 ("McIntyre, in excess of authority, made an agreement with [Quiksilver] and DC Shoes, to allow the utilization of IRC Section 3509 for the purpose of imposing minimal liability on the part of DC Shoes as a result of the IRS audit . . .").) The only additional cause of action alleged, for conspiracy between Quiksilver and McIntyre, is based on the same purported conduct that forms the basis of Blehm's fraud claim. (*See, e.g., id.*

¶¶ 55-60.)

III. PLAINTIFF'S COMPLAINT IS SUBJECT TO DISMISSAL BECAUSE THE CLAIMS ALLEGED THEREIN ARE BARRED BY RES JUDICATA.

The doctrine of res judicata, or claim preclusion, prevents a party from relitigating issues that have already been resolved. *Tyus v. Schoemehl*, 93 F.3d 449, 454 (8th Cir. 1996); *Montana v. U.S.*, 440 U.S. 147, 153 (1979). The purpose of res judicata is to alleviate overburdened courts and to protect defendants from being forced to defend multiple, potentially vexatious, law suits. *Id.* Three requirements must be present in order to bar a party from relitigating a claim on the grounds of res judicata: (1) there must be identity of claims in the original and subsequent actions; (2) there must be identity or privity between the parties to the original and subsequent action; and (3) there must have been a final judgment on the merits in the original action. *Stewart v. U.S. Bancorp*, 297 F.3d 953, 956 (9th Cir. 2002).

Because each of these requirements is met here, the Court should dismiss Blehm's claims for fraud and conspiracy on the grounds that Blehm had an opportunity to litigate these claims to finality in the State Court Action.

A. There is an Identity of Claims in this Action and the Previous State Court Action.

The fact that res judicata depends on an "identity of claims" does not mean that an imaginative attorney may avoid preclusion by attaching a different legal label to an issue that has, or could have, been litigated. Rather, "[i]dentity of claims exists when two suits arise from the same transactional nucleus of facts." *Tahoe-Sierra Pres. Council, Inc.v. Tahoe Reg'l Planning Agency*, 322 F.3d 1064, 1077-78 (9th Cir. 2003). "Newly articulated claims based on the same nucleus of facts may still be subject to a res judicata finding if the claims could have been brought in the earlier action." *Id.* at 1078, quoting *Barajas v. Northrop Corp.*, 147 F.3d 905 (9th Cir. 1998).

Blehm not only could have brought in the State Court Action the claims now alleged, ***he did bring these claims***. Indeed, the fraud claim alleged here is ***identical on its face*** to the claim Blehm alleged – and abandoned at trial – against DC Shoes. In the prior State Court Action, Blehm alleged that DC Shoes failed to disclose to him at the time he entered into the Settlement Agreement in August 2003 that DC Shoes intended to enter into a settlement with the IRS under Section 3509:

- Defendants affirmatively represented that Defendants would "pay all taxes, penalties and interest owing to the Internal Revenue Service relating to Blehm's prior employment with DC [Shoes]." (RJN Ex. 8 (State Court Complaint) ¶ 37)
- "[Defendants] knew the representation to be false, in that . . . at the time these representations were made, [Defendants] knew that they would enter into a settlement with the [IRS] pursuant to Internal Revenue Code § 3509, so that Blehm would remain responsible for paying the taxes, penalties, and interest relating to Blehm's prior employment with DC." (*Id.*; *see also id.* ¶¶ 38-42; *see also id.* ¶¶ 69-76 (intentional misrepresentation cause of action based on same facts).)

Here, Blehm alleges the identical claim, this time adding that Quiksilver too failed to disclose to him at the time he entered into the Settlement Agreement in August 2003 that DC Shoes intended to enter into a settlement with the IRS:

- Quiksilver, DC Shoes and the IRS reached an agreement to allow the utilization of Section 3509 to resolve DC Shoes' tax liability, with the goal of reducing DC Shoes' tax liability and imposing liability on Blehm (Complaint ¶ 50);
- "on or about July of 2003 . . . Quiksilver, Inc. failed to disclose to [Blehm] that [it] had reached a settlement in the IRS/DC Shoes

matter" (*id.* ¶ 45);

- "Defendant Betsy McIntyre, in excess of authority, made an agreement with [Quiksilver] and DC Shoes to allow the utilization of IRC Section 3509 for the purpose of imposing minimal liability on the part of DC Shoes . . ." (*id.* ¶ 50);
- "[Quiksilver] failed to disclose to [Plaintiff] that they had reached a settlement in the IRS/DC Shoes matter" (*id.* ¶ 45).

It is clear on the face of the two complaints that the claims here are one in the same with those Blehm already had the opportunity to litigate, as there is ***no independent basis*** for any liability on the part of Quiksilver. Blehm acknowledges as much in his Complaint, alleging not a single fact to suggest that any duty of disclosure was owed directly to him by Quiksilver. Rather, the Complaint and the documents judicially noticeable make clear that: (1) it was DC Shoes, not Quiksilver, that entered into a settlement with the IRS under Section 3509 (*see* Complaint ¶ 27; RJN Ex. 4 (Tax Court Decision); (2) it was DC Shoes, not Quiksilver, that entered into the Settlement Agreement with Blehm in August 2003 (Complaint ¶ 27; RJN Ex. 3 (Settlement Agreement)); and (3) Quiksilver did not acquire DC Shoes until well after both transactions occurred (*see, e.g.,* Complaint ¶ 29 (alleging Quiksilver agreed to acquire DC Shoes in January 2004); *id.* ¶ 51; RJN Ex. 8 (State Court Complaint) ¶ 31) (alleging Quiksilver acquired DC Shoes in March 2004).) Indeed, in acknowledgement that Quiksilver's liability is based on nothing more than its later acquisition of DC Shoes, the Complaint states that ***DC Shoes' obligations under the Settlement Agreement were later "assumed" by Quiksilver***. (*See id.* ¶ 51 (emphasis added).)

B. Blehm Was a Party to Both Actions and Quiksilver is in Privity With DC Shoes.

A prior judgment bars a subsequent action on the same claim only between the same parties or their privies. *See Hansberry v. Lee,* 311 U.S. 32, 40

(1940). "Privity can be an amorphous concept – that is, unless the courts have *already* determined that a particular relationship qualif[ies] for preclusion." 18 Moore's Federal Practice § 131.40[3][a], at 131-135 to 131-137 (3d ed. 2003) (noting varying approaches to privity analysis among different circuits) (emphasis in original).

Here, the privity analysis is simple. The Ninth Circuit – like several courts – has found that the relationship between a parent company and its wholly-owned subsidiary qualifies for preclusion. *See, e.g., Imperial Corp. of Am. v. FDIC*, 92 F.3d 1503, 1507 (9th Cir. 1996); *Lake at Las Vegas Investors Group v. Pacific Malibu Dev. Corp.*, 933 F.2d 724, 728 (9th Cir. 1991); *Sparks Nugget, Inc. v. Comm. of Internal Revenue*, 458 F.2d 631, 639 (9th Cir. 1972); *Pollard v. Cockrell*, 578 F.2d 1002, 1009 (5th Cir. 1978); *Whitehead v. Viacom*, 233 F. Supp. 2d 715, 721 (D. Md. 2002); *Greenberg v. Potomac Health Sys., Inc.*, 869 F. Supp. 328, 331 (E.D. Pa. 1994).

Indeed, in the Ninth Circuit, the parent-subsidiary relationship is "dispositive" proof of privity. *See Imperial Corp.*, 92 F.2d at 1507 ("FDIC's contention that '[t]he parent/subsidiary relationship of ICA and ISA, though potentially relevant, is not dispositive,' is unpersuasive in light of this court's clear holdings to the contrary.") (collecting cases); *see also Greenberg*, 869 F. Supp. at 330 ("To say they are not in privity is to suggest that a father is not privy to his son."). Thus, Quiksilver may invoke the Judgment in the State Court Action as a bar to this suit. Any other rule would impermissibly enable Blehm "to avoid the doctrine of res judicata by the simple expedient of not naming all possible defendants in [their] first action." *Ruple v. Vermillion*, 714 F.2d 860 (8th Cir. 1983). Blehm cannot credibly dispute that DC Shoes and Quiksilver are in privity for res judicata purposes. Indeed, the Complaint's allegation that Quiksilver "assumed" DC Shoes' obligations under the Settlement Agreement constitutes an acknowledgement that privity exists. (*See id.* ¶ 51.)

As the Complaint makes apparent, if any party is the proper party here it is DC Shoes, not Quiksilver. (*See, e.g.*, Complaint ¶ 27 ("On August 20, 2003, DC Shoes and [Blehm] entered into a Settlement Agreement"); *id.* ("concealed from [Blehm] at the time, was the fact that a month before, DC Shoes and the IRS had agreed under Section 3509 of the IRS Code that DC Shoes would be relieved of any requirement to pay the employment taxes, the net effect of which would shift the taxes to [Blehm] personally"). Blehm, however, has not surprising opted to not name DC Shoes as a party herein. His failure to do so, however, does not preclude Quiksilver, which is in privity with DC Shoes, from raising the Judgment entered in the State Court Action as a bar to Blehm's claims.

C. The State Court Action Was Litigated to Finality.

The application of res judicata requires that the first action resulted in a final judgment on the merits. There is no doubt that a Judgment was reached in the State Court Action. Blehm prosecuted his claims through trial resulting in a Judgment on the merits being entered on January 4, 2008. (*See* RJN Ex. 9 (State Court Judgment).) Although Blehm has filed an untimely motion for new trial and an untimely notice of appeal in the State Court Action, his untimely challenges do not preclude a finding that this Judgment is "final."[4]

Under California law, a party is required to file a motion for new trial at the *earliest* of: (1) 15 days after the clerk's mailing of notice of entry of judgment; (2) 15 days after service by a party of written notice of entry of judgment; or (3) the expiration of 180 days. *See* Cal. Code Civ. Proc. § 659. A notice of appeal must be filed at the *earliest* of: (1) 60 days after the party filing the

[4] Under federal law, an appeal or motion for new trial does not remove the "finality" from a judgment entered by the trial court for purposes of res judicata. However, this is not the case under California law, which holds that the filing of a motion for new trial or notice of appeal renders a judgment not final for purposes of res judicata. *See, e.g.*, *Sosa v. DIRECTV, Inc.*, 437 F.3d 923, 928 (9th Cir. 2006) (stating that where the previous judgment is a state court judgment, the law of the forum state governs as to the effect of a possible or pending appeal on claim preclusion).

notice of appeal serves or is served with a notice of entry of judgment or a file-stamped copy of the judgment; or (2) the expiration of 180 days. *See* C.R.C. 8.104.

Judgment was entered in the State Court Action on January 4, 2008. (RJN Ex. 9.) Blehm received notice of the entry of judgment that same day, on January 4, 2008. (*See id.* Ex. 10.) Blehm was thus required to move for a new trial by January 21, 2008[5] and to file his Notice of Appeal by March 4, 2008. Nonetheless, Blehm waited almost six months – until July 2, 2008 – to file both his notice of intent to move for a new trial and notice of appeal. (*See id.* Exs. 11, 12.) Thus, neither was timely. Under California law, the court lacks jurisdiction to consider a late-filed motion for new trial. "Timely filing is essential to the jurisdiction of the court to entertain a motion for a new trial." *Ehrler v. Ehrler*, 126 Cal. App. 3d 147, 151 (1981). "The trial court does not have the jurisdiction to make an order granting a new trial on its own motion. The power to grant a new trial may be exercised only through statutorily authorized procedure." *Id.; see also Marriage of Beilock*, 81 Cal. App. 3d 713, 721 (1978) ("It is well settled that a timely filing of the notice of intention to move for new trial is jurisdictional, and the time cannot be extended or waived by the parties."). Similarly, the California Court of Appeal may not consider a late filed appeal. "If a notice of appeal is filed late, the reviewing court must dismiss the appeal." C.R.C. 8.104(b).

DC Shoes has moved to strike Plaintiff's motion for new trial as untimely and has opposed Plaintiff's motion, in part, on the grounds that it was untimely. (RJN Exs. 13, 14.) DC Shoes' motion to strike is set to be heard by the state court on August 26, 2008. (*See* Ex. 13.) DC Shoes expects that the Court will grant its motion to strike and reject Plaintiff's new trial motion as untimely.

On July 14, 2008, Plaintiffs filed an Information Statement with the California Court of Appeals. (*Id.* Ex. 10 (Court of Appeals Information Statement).)

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[5] Because fifteen days fell on January 19, 2008, a Saturday, Blehm and FDC had until the following Monday, January 21, 2008, to file their Motion.

In that document, Plaintiffs notified the court that they had been served with a copy of the Judgment on January 4, 2008. (*See id.*) It is expected that the Court of Appeal will dismiss Plaintiffs' appeal upon a review of this document. In the event the Court of Appeal does not dismiss the appeal, DC Shoes intends to seek a dismissal of the appeal, in part, on the grounds that it was untimely. (Magnuson Decl. ¶ 2.)

In sum, neither Blehm's untimely motion for new trial nor his untimely appeal of the State Court Action, prevent the application of res judicata to bar Blehm's filing of identical claims in this subsequent action.

IV. ALTERNATIVELY, THE COURT SHOULD EXERCISE ITS DISCRETION TO STAY THIS ACTION PENDING RESOLUTION OF PLAINTIFF'S APPEAL AND MOTION FOR NEW TRIAL IN THE STATE COURT ACTION.

In the event that Blehm's Complaint is deemed not subject to dismissal on res judicata grounds because the State Court Action is construed as still "pending," this action should nonetheless be stayed pending resolution of the State Court Action. The United States Supreme Court has long recognized that, in certain circumstances such as those present in this case, a federal court may stay its hand in deference to a parallel state court proceeding. *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800 (1976). Abstention under such circumstances serves the interests of "wise judicial administration, giving regard to conservation of judicial resources and comprehensive disposition of litigation." *Id.* at 817.

Following the doctrine annunciated by the Supreme Court in *Colorado River*, courts in this Circuit have often stayed or dismissed a federal action due to the existence of a parallel action in state court. *See, e.g., 40235 Washington Street Corp. v. Lusardi*, 976 F.2d 587 (9th Cir. 1992); *Nakash v. Marciano*, 882 F.2d 1411 (9th Cir. 1989); *Fireman's Fund Ins. Co. v. Quackenbush*, 87 F.3d 290 (9th Cir. 1996).

In deciding whether abstention is appropriate under *Colorado River*, a federal court must first determine whether the issues raised in the federal and state cases are "parallel." If they are, then the Court weighs the following six factors:

(1) whether the jurisdiction is over any res or property;

(2) the relative convenience of the state and federal forums;

(3) the avoidance of piecemeal litigation;

(4) the order in which jurisdiction was obtained;

(5) whether federal or state law supplies the rule of decision; and

(6) whether the state court proceeding will adequately protect the rights of the party seeking federal jurisdiction. *See Colorado River*, 424 U.S. at 817; *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 15 (1983). These factors are not exhaustive, and "no one factor is necessarily determinative." *Colorado River*, 424 U.S. at 818. Here, all of the relevant factors noted by the Supreme Court in *Colorado River* strongly favor abstention.

A. The Issues Raised By Blehm in the State Court Action and this Action Are Parallel.

As a threshold matter, *Colorado River* abstention requires the existence of "parallel" state and federal actions. As the Ninth Circuit has held, precise identity between the issues raised in the state and federal proceedings is not required. Nor, must there be an identity of parties. Rather, abstention may be warranted so long as the state and federal actions are "substantially similar." *Nakash v. Marciano*, 882 F.2d 1411 (9th Cir. 1989) (staying federal proceeding despite lack of identity of parties and claims where cases involved the same core facts and therefore were "substantially similar").

Here, the state and federal cases are not only "substantially similar," they are essentially identical. As explained in Section II above, both in the State Court Action and here, Blehm has alleged fraud based on a purported failure to disclose that DC Shoes did not intend to pay his personal income taxes but, rather, intended to settle its claim with the IRS under Section 3509, which resulted in DC Shoes paying only a portion of the tax liability assessed against it, and Blehm not getting a credit for any amounts paid by DC Shoes against his own income tax liability.[6] Blehm is plaintiff in both actions. And, although new defendants have been named here, the Complaint makes clear that Quiksilver's liability is derivative of that of DC Shoes. Moreover, a complete identity of parties and issues is not required in order for a court to abstain under *Colorado River*. *See, e.g., Nakash,* 882 F.2d at 1416.

B. An Assessment of the Six *Colorado River* Factors Favors Abstention.

Further, when the six factors enumerated by the Supreme Court in *Colorado River* are weighed, the case for abstention here becomes all the more compelling.

This case does not involve an assertion of jurisdiction over a single res, so the first *Colorado River* factor is neutral, weighing neither for nor against abstention. *See Silvaco Data Sys. v. Technology Modeling Assocs.,* 896 F. Supp. 973, 976 (N.D. Cal. 1995) (noting that an irrelevant factor does not weigh for or against abstention). Similarly, the second *Colorado River* factor – the relative convenience of the state and federal forums – is neutral, given that Blehm is a citizen of California, and both DC Shoes and Quiksilver are headquartered in California. This factor is thus irrelevant and does not weigh against abstention.

Factor three – the avoidance of piecemeal litigation – heavily favors abstention in this case. The avoidance of piecemeal litigation is the single most important factor to be considered in deciding whether abstention is appropriate. *See*

[6] Though Blehm has also alleged herein a conspiracy cause of action, that claim is not distinct from his fraud claim. California law does not recognize an independent civil claim for conspiracy. Rather, "[a] conspiracy cannot be alleged as a tort separate from the underlying wrong it is organized to achieve." *ComputerXpress, Inc. v. Jackson*, 93 Cal. App. 4th 993, 1015 (2001) ("[C]onspiracy to commit a tort is not a separate cause of action from the tort itself").

Colorado River, 424 U.S. at 819; *Moses H. Cone*, 460 U.S. at 19 (avoidance of piecemeal litigation is the "paramount" consideration in the abstention analysis). The Ninth Circuit has stated that "[p]iecemeal litigation occurs when different tribunals consider the same issue, thereby duplicating efforts and possibly reaching different results." *American Int'l Underwriters, Inc. v. Continental Ins. Co.*, 843 F.2d 1253, 1256 (9th Cir. 1988).

Here, the risk of piecemeal litigation counsels strongly in favor of abstention. As noted in Section II above, the issues to be decided in this case – specifically, as to whether there was a failure to disclose to Blehm at the time of the Settlement Agreement an agreement between DC Shoes and the IRS under Section 3509 – are identical to what has been necessarily determined in the State Court Action. If the Judgment in the State Court Action does not yet have preclusive effect, it certainly will once Blehm's untimely motion for new trial and untimely appeal have been dismissed. There is simply no reason to expend valuable judicial (or party) resources litigating the same issues and same claims, on behalf of the same parties or their privies, in both state and federal forums.

Moreover, in the event this action moved quickly while Blehm's appeal was pending in the State Court Action, the simultaneous litigation of the same issues in state and federal courts would present a real risk of inconsistent rulings. Divergent holdings would cause confusion and potentially require additional litigation on issues of claim and issue preclusion – adding further uncertainty and needlessly driving up costs. The Supreme Court has recognized – and warned against – this very danger. In *Arizona v. San Carlos Apache Tribe of Arizona*, 463 U.S. 545 (1983), the Court advocated abstention where, as here, there is a genuine danger of inconsistent judgments: "since a judgment by either court would ordinarily be res judicata in the other, the existence of such concurrent proceedings creates the serious potential for spawning an unseemly and destructive race to see which forum can resolve the same issues first – a race [that would be] prejudicial to say the least, to the possibility of reasoned decisionmaking by either forum." *Id.* at 547.

The fourth *Colorado River* factor – the order in which the state and federal cases were filed – also weighs strongly in favor of abstention. As the Ninth Circuit has stated, there are two dimensions to this factor: (1) the order in which the complaints were filed; and (2) the extent to which the state and federal actions have progressed. *Travelers Indemnity Co. v. Madonna*, 914 F.2d 1364, 1370 (9th Cir. 1990). Both components cut in favor of abstention here. Blehm filed his State Court Action nearly two years before this action. And, as for the progress of the various actions, the State Court Action has already proceeded through trial. The only issues that remain are Blehm's pending – and untimely – motion for new trial and notice of appeal. In contrast, no substantive activity has occurred in this case. This Motion is Quiksilver's first appearance in this Court. (Magnuson Decl. ¶ 3.) Ms. McIntyre removed the case on July 28, 2008, and has not yet filed a response to the Complaint. (*Id.*) No discovery of any kind has taken place. (*Id.*) Accordingly, having progressed to trial and beyond, the State Court proceeding is obviously significantly further along and favors abstention.

The fifth factor – whether state or federal law controls – also favors abstention. The Supreme Court has held that, where a state court has jurisdiction over the claims arising in a later-filed parallel federal action, abstention can result in better efficiency and the avoidance of duplicative litigation. *See San Carlos Apache Tribe*, 463 U.S. at 567 ("[i]f the state proceedings have jurisdiction over the . . . rights at issue . . . then concurrent federal proceedings are likely to be duplicative and wasteful"). Here, not only do the state courts have jurisdiction over all the claims against Quiksilver, but each such claim arises under state law, making the case for abstention all the more compelling. *See Fireman's Fund Ins. Co. v. Garamendi*, 790 F. Supp. 938, 965 (N.D. Cal. 1992) (abstaining from case involving application of a state insurance-law initiative, noting that the litigation arose under state law and was already being litigated in a state court favored abstention). This case presents against Quiksilver only California state-law issues that California state courts are fully capable of resolving on their own. There is no need for additional, duplicative litigation in federal court, particularly given the more advanced stage of the State Court Action.[7]

The final factor – consideration of whether the state proceeding is adequate to protect the parties' rights – also weighs in favor of abstention. Because the claims in both the state and federal actions are identical, there is no question but that the state court was able to adjudicate fully Plaintiff's claims. There is simply no reason to maintain this parallel proceeding in federal court. This factor, therefore, weighs heavily in favor of abstention.

This six factors are not exclusive – the Court may consider other relevant factors, including whether the second suit is "an attempt to forum shop or avoid adverse rulings by the state court. *See Nakash*, 882 F.2d at 1417. It is apparent that, unsatisfied with the Judgment rendered in the State Court Action, Blehm is attempting to relitigate those claims in what, he hopes, will be a more favorable forum. Such tactics weigh heavily in favor of abstention. *See id.* (abstaining from hearing parallel case, noting that, "after three and one-half years, [plaintiff] has become dissatisfied with the state court and now seeks a new forum for their claims. We have no interest in encouraging this practice.").

This action against Quiksilver is a blatant attempt by Blehm to relitigate claims that he has already had an opportunity to litigate and which have afforded Blehm an ample opportunity for an appropriate remedy. In order to prevent this unnecessary and vexatious litigation, Quiksilver requests that, if the

[7] Nor should the naming of Ms. McIntyre as a defendant change the result. Although only state law claims have been alleged by Blehm, the naming of a former IRS agent granted this Court exclusive jurisdiction over the claims brought against Ms. McIntyre. However, any stay of this action will not prejudice Ms. McIntyre's opportunity to defend the claims brought against her in due course – likely, rather quickly, given the State Court Action is not far from resolution.

Court is not inclined to dismiss his claims on res judicata grounds, that it issue an order abating this later-filed action pending final resolution of the State Court Action.

V. PLAINTIFF FAILS TO PLEAD HIS CLAIMS WITH PARTICULARITY AS REQUIRED BY CALIFORNIA LAW.

Even if Blehm's claims could somehow survive the above challenges, his fraud and conspiracy claims still would be properly dismissed for failure to meet the strict pleading standards of Rule 9(b) of the Federal Rules of Civil Procedure. Rule 9(b) provides that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." This is not a mere technical requirement. On the contrary, it serves several important purposes:

> Rule 9(b) serves not only to give notice to defendants of the specific fraudulent conduct against which they must defend, but also "to deter the filing of complaints as a pretext for the discovery of unknown wrongs, to protect [defendants] from the harm that comes from being subject to fraud charges, and to prohibit plaintiffs from unilaterally imposing upon the court, the parties and society enormous social and economic costs absent some factual basis.

Bly-Magee v. California, 236 F.3d 1014, 1018 (9th Cir. 2001), quoting *In re Stac Elec. Sec. Litig.,* 89 F.3d 1399, 1405 (9th Cir. 1996).

To meet the requirements of Rule 9(b), Blehm must, *at a minimum*, specify the "time, place, and content of an alleged misrepresentation" or omission. *In re Glenfed Inc. Sec. Litig.*, 42 F.3d 1541, 1547-48 (9th Cir. 1994); *In re Stac*, 89 F.3d at 1404; *see also Schreiber Distrib. Co. v. Serv-Well Furniture Co.*, 806 F.2d 1393, 1401 (9th Cir. 1986) (complaint must specify "the time, place and specific content of the false representations as well as the identities of the parties to the misrepresentation."); *Vess v. Ciba-Geigy Corp.*, 317 F.3d 1097, 1106 (9th Cir.

2003) (complaint must set forth "'the who, what, when, where, and how" of the misconduct charged). Here, Quiksilver is entitled to know the "precise misconduct" with which it is charged "so that [it] can defend against the charge and not just deny that [it has] done anything wrong." *See Bly-Magee,* 236 F.3d at 1018, 1019.

Blehm's allegations fall far short of pleading "with particularity" the "time, place, and specific content of the false representations as well as the identities of the parties to the misrepresentation" or alleged omission. Both claims are premised on the same tenuous allegations: (i) that Quiksilver, DC Shoes and the IRS reached an agreement to allow the utilization of Section 3509 to resolve DC Shoes' tax liability, with the goal of reducing DC Shoes' tax liability and imposing liability on Blehm (*see, e.g.,* Complaint ¶ 50); (ii) that "on or about July of 2003 . . . Quiksilver, Inc. failed to disclose to [Blehm] that [it] had reached a settlement in the IRS/DC Shoes matter" (*see, e.g., id.* ¶ 45); and (iii) that had Blehm been aware that there was a settlement between the IRS and DC Shoes, he would not have sold his stock back to DC Shoes without a "hold harmless" agreement to ensure that his own personal tax liability would be paid. (*See, e.g., id.* ¶ 46.)

Blehm, however, does not allege the "facts" necessary to support this purported theory of liability against Quiksilver. Indeed, Blehm's allegations actually contradict any basis for liability by making it clear that, to the extent a duty was owed by anyone at all to disclose the Section 3509 settlement with the IRS, it was DC Shoes – not Quiksilver – that would have owed Blehm such a duty. For example, the Complaint does not allege how, why or in what manner Quiksilver was involved in the IRS's audit of DC Shoes, when Quiksilver made any alleged agreement with the IRS for the utilization of Section 3509, or who on behalf of Quiksilver was involved in reaching any such alleged agreement with the IRS. And, although the Complaint conclusorily alleges that Quiksilver had a duty to disclose to Blehm that an agreement had been reached between the IRS and DC

Shoes under Section 3509, it does state who on behalf of Quiksilver had the obligation to make this disclosure, on what basis Quiksilver representatives had a duty to make disclosures to Blehm and when this information should have been disclosed to Blehm – none of which it seems could logically be alleged given that Quiksilver did not acquire DC Shoes until long after Blehm had agreed to sell his stock back to DC Shoes in connection with the Settlement Agreement.

Nor does the Complaint plead reliance or damages based on the purported non-disclosure. The Complaint alleges that, had he known of the alleged Section 3509 agreement between DC Shoes and the IRS, Blehm would not have sold his stock without a "hold harmless" provision that his income tax would be paid by DC Shoes. (Complaint ¶ 46.) Completely undercutting the foregoing allegations, however, the Complaint alleges that, prior to the closing of Quiksilver's acquisition of DC Shoes and his receipt of the balance of the settlement proceeds, Blehm's lawyers "attempted to obtain confirmation that DC Shoes would indeed pay the employment taxes (later assessed against Blehm) once they received Plaintiff Clayton Blehm's stock at closing." (*Id.* ¶ 31.) Despite the fact that DC Shoes refused to confirm that Blehm's personal income taxes would be paid by DC Shoes, Blehm did not protest the closing and, indeed, proceeded to accept the remainder of the $15 million that was to be paid to him at closing under the terms of the Settlement Agreement. (*See id.* ¶ 32.) Blehm, too, fails to allege *how* he was damaged. While a plaintiff need not specifically plead the amount of damages, the fact that the plaintiff was harmed or injured, and the nature of such a harm or injury, is an element of a tort claims and must be specifically alleged.

Nor does the Complaint plead conspiracy with the requisite specificity. The Complaint is devoid of any allegations regarding who on behalf of Quiksilver conspired to defraud Blehm, what specific conspiracy was formed, when this conspiracy was allegedly formed and how it was carried out or operated.

What should be very apparent from the Complaint's allegations is that

Blehm cannot ***in good faith*** allege any wrongdoing on the part of Quiksilver. In such a case, the proper remedy is to grant a Motion to Dismiss the Complaint.

VI. CONCLUSION.

For the foregoing reasons, Quiksilver respectfully requests that the Court grant its Motion to Dismiss on the basis of res judicata or, in the alternative, stay this action pending resolution of the prior State Court Action. In the event the Court finds neither appropriate, Quiksilver respectfully requests that the Court dismiss the Complaint for failure to satisfy the pleading requirements of Rule 9(b).

Dated: August 4, 2008

MICHAEL G. YODER
MOLLY J. MAGNUSON
O'MELVENY & MYERS LLP

By: [signature]
Molly J. Magnuson
Attorneys for Defendant
QUIKSILVER, INC.

PROOF OF SERVICE BY MAIL

I am over the age of eighteen years and not a party to the within action. I am a resident of or employed in the county where the service described below occurred. My business address is 610 Newport Center Drive, 17th Floor, Newport Beach, California 92660-6429. I am readily familiar with this firm's practice for collection and processing of correspondence for mailing with the United States Postal Service. In the ordinary course of business, correspondence collected from me would be processed on the same day, with postage thereon fully prepaid and placed for deposit that day with the United States Postal Service. On August 4, 2008 I served the following:

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF QUIKSILVER INC.'S MOTION TO DISMISS PLAINTIFF'S COMPLAINT OR, IN THE ALTERNATIVE, MOTION TO STAY ACTION PENDING RESOLUTION OF PRIOR STATE COURT ACTION

by putting a true and correct copy thereof in a sealed envelope, with postage fully prepaid, and placing the envelope for collection and mailing today with the United States Postal Service in accordance with the firm's ordinary business practices, addressed as follows:

Lauren Castaldi
Trial Attorney, Tax Division
U.S. Department of Justice
P.O. Box 683
Ben Franklin Station
Washington, D.C. 20044

Roy R. Withers, Esq.
Law Office of Roy R. Withers
2802 Juan Street, Suite 12
San Diego, CA 92110

I declare under penalty of perjury under the laws of the State of California that the above is true and correct. Executed on August 4, 2008, at Newport Beach, California.

[signature]
Adonna Payne